

Part I

Section 4975: -- Tax On Prohibited Transactions

26 CFR 54.4975-1: General rules relating to excise tax on prohibited transactions.

Rev. Rul. 2002-43

ISSUE

When a loan from a qualified plan that is a prohibited transaction spans successive taxable years, and thus constitutes multiple prohibited transactions, and during those years the first tier prohibited transaction excise tax rate under § 4975 of the Internal Revenue Code changes, how is the excise tax computed?

FACTS

X, Inc. is a Subchapter C corporation that sponsors Plan Y, a calendar year profit sharing plan qualified under § 401(a) of the Internal Revenue Code. Plan Y's plan year is the calendar year. On April 1, 1997, individual B, a disqualified person with respect to Plan Y, obtained a two-year loan in the amount of \$10,000 from Plan Y's tax-exempt trust. The loan was secured solely by B's account balance in Plan Y. At the time of the loan, B's account balance was \$12,000. According to the terms of the loan, B was to make substantially equal payments of principal and interest to Plan Y's trust on the first business day of every calendar quarter. The interest rate of the loan was 11%, compounded annually, which was equal to or greater than a fair market rate of interest for such a loan at that time. B made no payments on the loan until December 31, 1999, at which time B repaid the loan, including principal and accrued interest. The repayment constituted a "correction" within the meaning of § 4975(f)(5) of the Code. None of the Forms 5500 that were filed for Plan Y for 1997, 1998, or 1999 reflected a loan to B.

LAW AND ANALYSIS

Section 4975(a) of the Internal Revenue Code provides that an excise tax is imposed as a result of each prohibited transaction on any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such). Section 4975(c)(1)(B) of the Code defines the term “prohibited transaction” as including any direct or indirect lending of money or other extension of credit between a plan and a disqualified person.

Section 4975(d)(1) provides a statutory exemption for a loan made to a disqualified person who is a participant or beneficiary of the plan if such loan (1) is available to all such participants or beneficiaries on a reasonably equivalent basis; (2) is not made available to highly compensated employees (within the meaning of § 414(q)) in an amount greater than the amount made available to other employees; (3) is made in accordance with specific provisions regarding such loans set forth in the plan; (4) bears a reasonable rate of interest; and (5) is adequately secured.

Under section 102(a) of Reorganization Plan No. 4 of 1978 (43 F. R. 47713, October 17, 1978, 1979-1 C.B. 480), the Secretary of Labor has the authority to issue regulations interpreting § 4975(d)(1) of the Code and the parallel provision in section 408(b)(1) of the Employee Retirement Income Security Act of 1974 (“ERISA”). Under 29 C.F.R. 2550.408b-1(f)(2) of the Department of Labor's regulations, a loan secured solely by more than 50 percent of the present value of a participant's vested accrued benefit is not adequately secured for purposes of determining whether the loan is exempt from the prohibited transaction excise tax.

Section 1453(a) of the Small Business Job Protection Act of 1996 increased the first tier excise tax rate of § 4975(a) of the Code from 5% to 10% of the amount involved for each year in the taxable period for prohibited transactions occurring after August 20, 1996. Section 1074(a) of the Taxpayer Relief Act of 1997 increased the first tier excise tax rate to 15% of the amount involved for each year in the taxable period for prohibited transactions occurring after August 5, 1997. Section 4975(f)(2) of the Code defines the

term “taxable period” as the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of (1) the date of the mailing of a statutory notice of deficiency, (2) the date on which the first tier excise tax is assessed, or (3) the date on which correction of the prohibited transaction is completed. Section 4975(f)(4) defines the term “amount involved,” with respect to a prohibited transaction, as the greater of (1) the amount of money and the fair market value of the other property given or (2) the amount of money and the fair market value of the other property received in such transaction. For purposes of the first tier excise tax, the fair market value is determined as of the date on which the prohibited transaction occurs.

Section 141.4975-13 of the Temporary Pension Excise Tax Regulations provides that until superseded by permanent regulations under paragraphs (4) and (5) of § 4975(f) of the Code, § 53.4941(e)-1 of the Foundation Excise Tax Regulations will be controlling to the extent those regulations describe terms appearing both in § 4941(e) and § 4975(f). The term “amount involved” appears in both § 4941(e) and § 4975(f).

Section 53.4941(e)-1(b)(2)(ii) of the Foundation Excise Tax Regulations provides that, where the transaction involves the use of money, the amount involved is the greater of the amount paid for such use or the fair market value of such use for the period for which the money or other property is used and the amount involved is determined for the entire period that the money is used. In addition, § 53.4941(e)-1(e)(1) provides that, in the instance of a prohibited transaction that is a loan, an additional prohibited transaction is deemed to occur on the first day of each taxable year in the taxable period after the taxable year in which the loan occurred.

The interest amount for each year under the facts described above is computed as follows:

Year	Principal	Rate	Time	Interest Amount
1997 (4/1-12/31)	\$10,000.00	11.00%	275/365 year	\$ 828.77
1998	\$10,828.77	11.00%	1 year	1,191.16
1999	12,019.93	11.00%	1 year	1,322.19

Under the facts described above, and applying the rule in § 53.4941(e)-1(e)(1),

there are three prohibited transactions that result from this loan. The first prohibited transaction occurs on the date of the loan (April 1, 1997), the second prohibited transaction occurs on January 1, 1998 (the first day of the next taxable year) and the third prohibited transaction occurs on January 1, 1999. The taxable period for each of these prohibited transactions begins on the date that the prohibited transaction occurs (April 1, 1997 for the first prohibited transaction, January 1, 1998 for the second prohibited transaction, and January 1, 1999 for the third prohibited transaction). The taxable periods for all three prohibited transactions end on the date on which the prohibited transactions were corrected (December 31, 1999). The amount involved for each prohibited transaction is the interest amount, as computed in the preceding table, for the first taxable year in the taxable period for that prohibited transaction. Therefore, the first-tier prohibited transaction excise tax for each prohibited transaction is computed as follows:

Year	1 st Prohibited Transaction Excise Tax	2 nd Prohibited Transaction Excise Tax	3 rd Prohibited Transaction Excise Tax
1997	\$ 828.77 x .10 = \$ 82.88	-----	-----
1998	828.77 x .10 = 82.88	\$1,191.16 x .15 = \$178.67	-----
1999	828.77 x .10 = <u>82.88</u>	1,191.16 x .15 = <u>178.67</u>	\$1,322.19 x .15 = <u>\$198.33</u>
1st tier tax	\$248.64	\$357.34	\$198.33

Total for All Prohibited Transactions = \$804.31.

HOLDING

When a loan from a qualified plan that is a prohibited transaction spans successive taxable years, and thus constitutes multiple prohibited transactions, and during those years the first tier prohibited transaction excise tax rate changes, the first tier excise tax liability for each prohibited transaction is the sum of the products resulting from multiplying the amount involved for each year in the taxable period for that prohibited transaction by the excise tax rate in effect at the beginning of that taxable period.

Drafting Information

The principal author of this revenue ruling is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday. Mr. Rubin can be reached at 1-202-283-9888 (not a toll-free number).